

Message Text

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C O N F I D E N T I A L BRUSSELS 2649

LIMDIS

DEPARTMENT PLEASE PASS TREASURY AND FRB

REF: A. EC BRUSSELS 1368 (NOTAL) B. EC BRUSSELS 9877, DEC.

13, 1974 (NOTAL)

1. BEGIN SUMMARY: EC COMMISSION OFFICIALS REPORT A GENERAL WILLINGNESS AMONG MOST G-10 CENTRAL BANKERS TO CONSIDER COOPERATING IN A JOINT OPERATION TO SMOOTH OUT DAILY FLUCTUATIONS OF THE DOLLAR EXCHANGE RATE. WHILE SOME TECHNICAL PROBLEMS STILL NEED TO BE WORKED OUT, THE EC CENTRAL BANKERS ARE REPORTEDLY HOPEFUL THAT THIS OPERATION COULD BE LAUNCHED ON A TRIAL BASIS AFTER THEIR MID-APRIL MEETING. COMMISSION OFFICIALS SEE THIS AS A STEP TOWARD PREVENTING DESTABILIZING CURRENCY FLUCTUATIONS. END SUMMARY.

2. EC COMMISSION OFFICIALS TELL US THAT AT THE MARCH 10 MEETING OF G-10 CENTRAL BANKERS IN BASEL, THERE WAS A GENERAL WILLINGNESS TO CONSIDER AN EXPERIMENTAL JOINT OPERATION TO SMOOTH OUT THE DOLLAR EXCHANGE RATE (SEE REFTELS). THE OBJECTIVES WOULD BE TO PREVENT ERRATIC DAILY MOVEMENTS OF EUROPEAN CURRENCIES' EXCHANGE RATES AGAINST THE DOLLAR. BY CO-OPERATING IN THE INTERVENTION IN EXCHANGE MARKETS, EUROPEAN
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CENTRAL BANKS WOULD ATTEMPT TO KEEP THE DAILY FLUCTUATION

OF THEIR EXCHANGE RATES AGAINST THE DOLLAR TO WITHIN ONE PERCENT. CENTRAL BANKS WOULD MAKE THEIR BEST EFFORTS TO ABIDE BY THIS PROCEDURE. THEY WOULD CONSULT WITH OTHER PARTICIPANTS, ESPECIALLY IF THEY FIND IT NECESSARY TO ALLOW THEIR DAILY RATES TO FLUCTUATE BY MORE THAN ONE PERCENT. THE INTENT IS NOT TO HOLD EXCHANGE RATES AT OTHER THAN EQUILIBRIUM LEVELS NOR TO RESIST FUNDAMENTAL MARKET FORCES. INSTEAD, THE BANKS WOULD MERELY ATTEMPT TO SMOOTH OUT FLUCTUATIONS IN FOREIGN EXCHANGE RATES.

3. EC CENTRAL BANK GOVERNORS REPORTEDLY AGREED IN PRINCIPLE ON MARCH 11 TO IMPLEMENT THIS OPERATION. IF TECHNICAL DETAILS ARE WORKED OUT, ESPECIALLY WITH US AUTHORITIES, FORMAL APPROVAL IS EXPECTED AT THE NEXT MEETING OF THE EC GOVERNORS, WHICH WILL PROBABLY BE ON APRIL 15. ONCE APPROVAL IS OBTAINED, THE SCHEME WOULD BE PUT INTO OPERATION. AT THIS TIME WE DO NOT KNOW IF ALL THE EC MEMBER STATES ARE PLANNING TO PARTICIPATE; PREVIOUSLY THE UK AND ITALY HAD RESERVATIONS. COMMISSION OFFICIALS BELIEVE THE UK NOW PLANS TO PARTICIPATE BUT ITALY REPORTEDLY REMAINS NON-COMMITTAL. NORWAY AND SWEDEN ARE ALSO EXPECTED TO PARTICIPATE. COMMISSION OFFICIALS ARE ENCOURAGED THAT US OFFICIALS AT THE BASEL MEETING REPORTEDLY INDICATED A WILLINGNESS TO CONSIDER PARTICIPATING ON AN EXPERIMENTAL BASIS, PERHAPS FOR A TWO-MONTH TRIAL PERIOD.

4. THE EXPERTS (HAYVAERT GROUP) OF THE EC CENTRAL BANKERS GOVERNORS COMMITTEE HAVE NEARLY COMPLETED THE TECHNICAL ARRANGEMENTS FOR THIS OPERATION AND WILL MEET AGAIN ON APRIL 1-2 HOPEFULLY TO FINISH THEIR WORK. THE PROBLEM CREATED BY THE DIFFERENT CLOSING TIMES OF THE EUROPEAN AND NY MARKET HAS REPORTEDLY BEEN SOLVED BY THE EUROPEANS AGREEING TO ADOPT THE NY RATE FOR THE STARTING POINT OF THEIR NEXT DAY'S TRADING AND VICE-VERSA FOR THE FRB. SINCE THE FRB DOES NOT HAVE ON HAND SUBSTANTIAL RESERVES OF FOREIGN CURRENCIES, IT MAY HAVE TO DRAW ON ITS LINES OF CREDIT WITH EUROPEAN CENTRAL BANKS TO FINANCE INTERVENTIONS. THIS COULD CREATE SOME PROBLEMS BUT COMMISSION OFFICIALS SEE NO ALTERNATIVE TO THIS PROCEDURE.

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5. COMMISSION OFFICIALS BELIEVE THAT IMPLEMENTATION OF THIS SMOOTHING-OUT OPERATION WOULD BE A STEP TOWARD INCREASED MONETARY STABILITY. THEY INDICATE THAT LITTLE PROGRESS CAN BE MADE IN CONVERGING THE MEMBER STATES' ECONOMIC POLICIES UNTIL THERE IS GREATER STABILITY IN FOREIGN EXCHANGE MARKETS. TO STABILIZE EUROPEAN EXCHANGE MARKETS, COMMISSION OFFICIALS RECOGNIZE THAT THE US MUST BE INVOLVED. COMMISSION OFFICIALS ARE CONSEQUENTLY PLEASED OVER THE REPORT THAT THE

US MAY COOPERATE IN THE SMOOTHING-OUT OPERATION. THEY INTERPRET THIS AS A STEP TOWARD CLOSER US/EC ECONOMIC CO-OPERATION.

6..COMMENT: THE IMPORTANCE OF THIS PROPOSED SMOOTHIN-OUT OPERATION MAY BE OVERBLOWN BY SOME COMMISSION OFFICIALS. AT BEST IT IS ONLY A MODEST FIRST STEP. WE ARE TOLD THAT LAST YEAR THE DAILY MOVEMENT OF EUROPEAN EXCHANGE RATES AGAINST THE DOLLAR EXCEEDED ONE PERCENT ONLY ABOUT TWELVE TIMES. MANY COMMISSION OFFICIALS FEEL, HOWEVER, THAT FLOATING EXCHANGE RATES HAVE BEEN A MAJOR FACTOR IN THE LACK OF PROGRESS TOWARD EUROPEAN MONETARY INTEGRATION. THEY CONSEQUENTLY ARE ANXIOUS TO PROMOTE STEPS THAT MIGHT LEAD TO MONETARY STABILITY. THEY REALIZE THAT A RETURN TO FIXED EXCHANGE RATES IS NOT FEASIBLE OR DESIRABLE AT THIS TIME. THEY BELIEVE, HOWEVER, THAT JOINT ACTION IS NEEDED TO PREVENT THE DISRUPTIVE EFFECTS OF SHARP EXCHANGE FLUCTUATIONS. ACCORDING TO THESE OFFICIALS, THIS CAN ONLY BE ACCOMPLISHED BY A COMPRESHENSIVE UNDERSTANDING AMONG THE MEMBER STATES AND BETWEEN THE EC AND THE US OF EACH OTHER'S INVOLVEMENT IN CURRENCY MARKETS, AS WELL AS IMPROVED COORDINATION OF ECONOMIC POLICIES. END COMMENT. GREENWALD

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